Moody's Investors Service
Global Credit Research

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UK Electricity Sector - Business Separation Under The UK Utilities Act 2000

No Adverse Effects For Existing Bondholders, But Differentiation Of Ratings Within Corporate Families As Group Structures Have Become More Diverse And Complex

Summary Opinion

- Legal separation of distribution and supply of UK Public Electricity Suppliers has not led to a deterioration of credit quality for existing bondholders.
- Some divergence in credit ratings has emerged within some corporate families due to exposure of creditors to different business risks, legal or structural subordination, and regulatory ring-fencing.
- Broadly speaking, the effects on existing utility bonds fell into three categories: (i) bonds were "pushed down" to the new regulated distribution subsidiaries; (ii) bonds remained with the original issuer but now benefit from an upstream guarantee from the regulated business, and (iii) there was no effect.
- Some UK utilities have used the business separation process to carry out wider group restructurings.

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I. Utilities Act 2000: Separation Of Distribution And Supply Activities

THE UTILITIES ACT INTRODUCED IMPORTANT REGULATORY CHANGES

The UK Utilities Act 2000 introduced several significant changes to UK electricity industry regulation. In essence, these changes were aimed at addressing the increasing inter-relationships between electricity and gas markets, to strengthen consumer protection, and to amend the licensing framework in order to bolster competition in energy supply. Specifically, the Utilities Act

- created the Gas and Electricity Markets Authority ("the Authority" or "the Regulator") to succeed to the offices of the former Directors General of Gas and Electricity Supply as the body in which are now vested the powers and duties previously held by the Directors General created by the Electricity Act 1989 and the Gas Act 1986 (both as amended by the Utilities Act 2000). OFGEM (the Office of Gas and Electricity Markets) provides staff for the Authority and reports to it,
- made the protection of the interests of consumers a principal objective of the Authority,
- conveyed powers to the Authority to adapt the licensing regime and to align the regimes of the gas and electricity businesses, and
- required the Public Electricity Supply licenses to be replaced by separate licenses for distribution and supply, and required these licenses to be held by separate legal entities.

Prior to the implementation of the Utilities Act 2000, the UK electricity sector had two types of supply licenses: first tier licenses and second tier licenses. First tier suppliers were the Regional Electricity Companies ("RECs") that held a Public Electricity Supply ("PES") license covering both distribution and supply in an authorised area. Second tier supply licenses covered the activities of the RECs outside their franchise areas as well as independent third-party suppliers. The Utilities Act abolished this distinction between first and second tier supply licenses, and introduced distribution as a separate licensed activity. This became effective on 1 October 2001.

LICENSE AND LEGAL SEPARATIONS AIM TO STRENGTHEN THE REGULATORY RING-FENCING FOR DISTRIBUTION

One of the principal objectives for the separation of supply and distribution is to tighten the regulatory ring fencing around the monopoly distribution businesses.

The primary purpose of this financial ring-fence is "to ensure that the license holders do not lose control of the financial resources generated from their price-regulated activities, nor divert them to other purposes, except to the extent they are wholly surplus to the requirements of those activities"[1].

The main change compared to the previous ring fence is a reduction in the de-minimis limit relating to activities other than the distribution business. Any de-minimis business by the licensee is now restricted to 2.5% (previously 5%) of the aggregate distribution business turnover and shall not exceed 2.5% of the licensee's equity.

Other key license conditions remain unchanged, in particular:

- the licensee's obligation to secure sufficient management resources, financial resources, and financial flexibility to enable it to carry on the distribution business;
- the obligation to "use all reasonable endeavours to ensure that the licensee maintains at all times an investment grade issuer credit rating",
- an undertaking from the ultimate parent company that it will refrain from any action which would be likely to cause the licensee to breach any of its obligations under law or the license,
- restrictions on the disposal of or relinquishing operational control over any relevant assets. Any such disposal requires the consent from the Regulator except in certain limited circumstances; and
- the licensee shall not declare a dividend or make any form of distribution unless it has provided the Regulator with a compliance certificate stating, among others, that the dividend or distribution (either alone or taken together with other circumstances) does not cause the licensee to be in breach of its obligations.

1 *Electricity distribution licenses; Proposals on standard conditions for the financial ring-fence. A decision document, Office of Gas and Electricity Markets, April 2000, p. 22*

NO RING-FENCING FOR SUPPLY ACTIVITIES, BUT STRENGTHENED SUPPLIER OF LAST RESORT PROCEDURES

No financial ring fence conditions were introduced into the new licenses for the supply business, as electricity supply is no longer a monopolistic activity. The Regulator points out that "it would be inconsistent with the development of a competitive market if some participants were to be protected from the risk of financial failure"[2].

Whilst the Regulator continues to have a general duty to "secure that licence holders are able to finance the carrying on of the activities which they are authorised by their licences to carry on"[3], he is satisfied that adequate safeguards against the consequences of financial failures are provided by the ability of customers to switch to a different supplier, and by the power of the Regulator to revoke a supply license and to appoint an alternative supplier to take over responsibility for customers of a supplier whose license has been revoked.

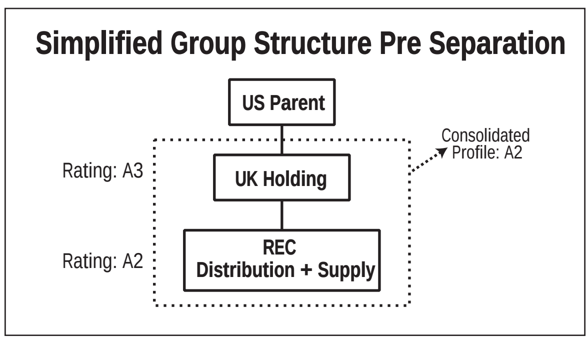
As part of the Utilities Act, the acts of revoking a license and appointing an alternative supplier have been aligned for electricity and gas, and the processes have been streamlined. Events where this may happen include the appointment of a receiver, the issue of an administrative order, or a supplier being unable to pay its debt within the meaning of the UK Insolvency Act.

Against this background and considering that the supply business is one of the most competitive segments of the electricity market, Moody's associates a very high business risk with a stand-alone supply business. It is also for this reason that Moody's uses a differentiated approach to rating subsidiaries within a corporate family, taking into account the type of business risk that a creditor is exposed to.

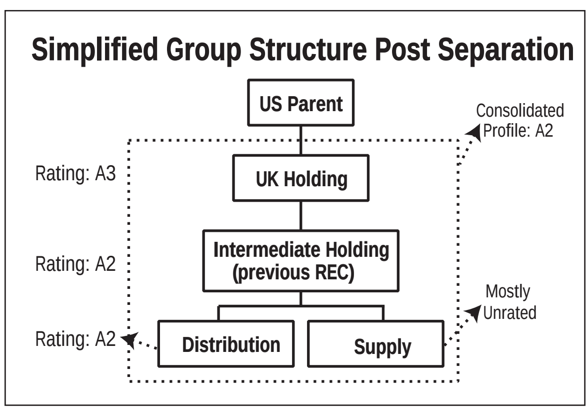
II. Business Separation: Effects On Group Structures And Ratings

TYPICAL GROUP STRUCTURES PRE AND POST BUSINESS SEPARATION

Since by 1998 all twelve England & Wales Regional Electricity Companies (RECs) had been taken over either by US or other UK utilities, many of the companies had a group structure that included debt at the REC level and acquisition debt at an intermediate holding company. Bonds at the acquisition holding level were typically rated one notch below debt at the REC level to reflect structural subordination to the ring-fenced operating subsidiary. The figure to the left shows a simplified but typical UK REC structure together with a ratings example.



The business separation process under the UK Utilities Act in many cases led to the creation of two new subsidiaries underneath the former REC, with the REC becoming an intermediate holding company. The distribution and supply activities were then transferred to these new subsidiaries. Given the asset base of the distribution network activities, the asset transfers to the new subsidiaries occurred in exchange for a combination of equity and inter-company loan stock.



A typical corporate structure post business separation is shown in the figure to the left. Some UK utilities have implemented a wider group restructuring at the same time as business separation came into effect. Appendix V gives an idea of the diversity and complexity of some of the present structures.

2 *Electricity distribution licenses; Proposals on standard conditions for the financial ring-fence. A decision document, Office of Gas and Electricity Markets, April 2000, p. 20*

3 *Electricity Act 1989, Section 3 (1) b)*

IMPLICATIONS FOR EXISTING BONDHOLDERS

Overall, legal separation of distribution and supply of UK Public Electricity Suppliers has not led to a deterioration of credit quality for existing bondholders.

Bonds issued at UK holding company levels, typically Yankee or Sterling bonds issued for the acquisition of a REC, have remained with the issuing entity and have not been affected.

Bonds issued by the former Public Electricity Supply license holder were either "pushed down" to the new ring-fenced monopoly distribution license holder ("DLH"), or they remained with the original issuer but now benefit from an upstream guarantee from the regulated distribution subsidiary. Whilst the financial ring-fencing provisions generally preclude the regulated license holder from providing financial assistance or guarantees to other group affiliates, such up-stream guarantees for existing debt were the subject of specific consents given by the Authority contemporaneously with the transfer schemes. The consents are conditional on continuing compliance by the issuers with specific provisions that vary from case to case, designed to mitigate risk to the regulated business.

There was a third group of utilities for which bonds were unaffected. These were:

- the majority of the "distribution-only" utilities - Western Power Distribution Holding with its two regulated subsidiaries Western Power Distribution (South West) plc (the former SWE plc) and Western Power Distribution (South Wales) plc (the former Infralec), and United Utilities' United Utilities Electricity PLC (formerly Norweb plc),
- Powergen - which repaid the two bonds of East Midlands Electricity (formerly Powergen Energy plc) in December 2000, and
- Eastern Electricity Ltd - bonds were unaffected as they stayed with Eastern Electricity as the new distribution license holder. The transfer of the supply business out of Eastern Electricity was not deemed a material change.

The figure below gives an overview of the effects on the various companies.

Bonds pushed down to DLH	**Bonds stay at former PES/issuer + guarantee from DLH**	**No effect/ Other**
• SEEBOARD • Yorkshire Electricity • London Electricity • Southern Electric ($ bond)	• Manweb (Scottish Power UK) • SP Distribution (Scottish Power UK) • Northern Electric • Midlands Electricity (GPU Power UK) • Southern Electric (£ bond) (SSE) • Scottish Hydro-Electric Distribution (SSE)	• East Midlands (Powergen) • WPD (S Wales) (WPDH) • WPD (S West) (WPDH) • UUE (United Utilities) • Eastern E (TXU Europe)

RATIONALE FOR RATINGS ASSESSMENT

In general, Moody's has observed some divergence in credit ratings within a corporate family after business separation due to exposure of creditors to different business risks, legal or structural subordination, and regulatory ring-fencing.

In those cases in which the former PES has become a pure intermediate holding company and is not expected to issue any material external debt, the ratings of the new regulated distribution license subsidiaries and those of the former PES are the same. Examples of this include GPU Power Networks (UK) plc/Midlands Electricity plc, Northern Electric Distribution Ltd/Northern Electric plc, and SEEBOARD Power Networks plc/SEEBOARD plc.

Ratings assigned to new generation, supply and trading entities reflect the higher business risks compared to ratings of regulated network affiliates in the absence of any explicit parent company support or other offsetting considerations. Ratings assigned to the new operating subsidiaries of Scottish Power UK are a good example of this. In the case of SEEBOARD Energy Ltd, its rating is based on the credit of SEEBOARD plc and is also formally underpinned through a keep-well agreement.

In the case of London Electricity Group companies, Moody's continues to rate all entities within the corporate chain at the same level, as we consider the effects of structural subordination (e.g. London Electricity Group Holdings to London Electricity Group) to be offset by the significant credit support from the ultimate parent, Electricite de France (EDF, AAA).

Upon maturity of existing bonds, Moody's would expect refinancings in the majority of the UK utilities to occur at the level of the regulated distribution license holding subsidiary.

III. The Changing Structure Of The UK Electricity Industry

Whereas the statutory requirement for business separation only became effective in October 2001, some UK utilities had actually started to separate ownership of supply and distribution activities prior to implementation of the new legislation. Since 1999, the following five supply businesses had changed ownership prior to October 2001:

- Midlands Electricity supply business - acquired in 1999 by Innogy from Avon Energy/GPU
- South Western Electricity supply business - acquired in 1999 by London Electricity Group from WPD
- Norweb Energi supply business - acquired by TXU Europe in 2000
- South Wales Electricity supply business - eventually acquired by Scottish and Southern Energy in 2000
- Northern Electric supply business - acquired by Innogy by way of an asset swap with CE Electric UK in August 2001

This restructuring has led to four UK utilities exiting the competitive supply business all together to focus on regulated distribution activities:

- GPU Power UK,
- Western Power Distribution,
- MidAmerican/CE Electric, and
- United Utilities.

Consolidation has led to a reduction of the number of UK utilities that own regulated distribution network businesses from 14 (the 12 former RECs plus the two Scottish utilities) to 9. Of those nine companies, there are five utilities that now own two distribution licenses and businesses.

At the other end of the spectrum, there are now six substantially vertically integrated utility groups in the UK that have chosen to grow their supply businesses significantly in pursuit of economies of scale. Many of these have acquired two or even three former franchise supply businesses:

- Innogy,
- TXU Europe,
- Powergen,
- London Electricity Group,
- Scottish Power, and
- Scottish and Southern Energy.

The only company left that essentially resembles the "old" REC model is SEEBOARD plc, with one distribution and one supply business.

Appendix II provides an up-dated overview of the UK electricity industry with respect to distribution and supply.

Appendix I: Glossary Of Terms And Abbreviations Used

DLH	Distribution License Holder
DTI	Department of Trade and Industry
IPP	Independent Power Project
NETA	New Electricity Trading Arrangements
OFGEM	The Office of Gas and Electricity Markets
PES	Public Electricity Supply Company
REC	Regional Electricity Company

Appendix II

Ownership Overview of UK Electricity Utilities

(as per December 2001)

	Innogy	TXU Europe	Powergen (*)	EDF/London Electricity	Scottish Power	Scottish & Southern
Distribution	none	none	East Midlands Electr. Distr. (1998) (formerly Powergen Energy)	London + 24Seven (1999) Eastern + 24Seven (2001) (***)	SP Distribution Manweb (1995)	Scottish Hydro-Electric Distribution Southern Electric (1998)
Retail	Midlands Electricity (1999) Yorkshire (2001) Independent Energy (2000) Northern Electric (2001)	Eastern (1999) Norweb Energi (2000)	Powergen Retail (1998) (formerly part of EME)	London Electricity (1999) SWEB (1999)	Scottish Power Manweb (1995)	Scottish Hydro-Electric Southern Electric (1998) SWALEC (2000)

	AEP	United Utilities	MidAmerican/Berkshire	WPD (Mirant/PP&L)	FirstEnergy (**)
Distribution	SEEBOARD Power Networks (1996)	United Utilities Electric (1995) (formerly Norweb)	Northern Electric (1996/00) Yorkshire Electricity (2001)	WPD (S West) (1995) (formerly SWE) WPD (S Wales) (2000) (formerly Infralec)	Midlands Electricity (1995) (trading under GPU Power UK)
Retail	SEEBOARD (1996)	none	none	none	none

(*) April 2001: conditional offer by E.On AG to purchase Powergen. Subject to approvals
(**) October 2001: offer by Utilicorp United to purchase Avon Energy Partners/GPU Power UK. Subject to approvals
(***) November 2001: offer by London Electricity Group to TXU Europe to acquire the Eastern Electricity distribution business and TXU Europe's 50% share in 24Seven

Appendix III: UK Electricity Distribution Regions (as per December 2001)

Appendix IV:
UK Electric Utility Groups—Moody's Ratings

I. Integrated Utilities

Electricité de France	Aaa/P-1
London Electricity Group Holdings plc	A2
EDF London Capital LP	A3 (subordinated)
London Electricity Group plc	A2/P-1
London Power Networks	A2/P-1
London Electricity plc	A2
Eastern Electricity plc (1)	A3*
Sutton Bridge Financing Ltd	Baa3
Innogy plc	Baa1/P-2
Powergen plc(2)	Baa1*
PowerGen UK plc	A3*/P-2*
PowerGen (East Midlands) Investments	A3*
East Midlands Electricity Distribution plc	
Powergen US Holdings	
LG&E Energy Corp	A3*
Kentucky Utilities Co.	A2
Louisville Gas & Electric Company	A2/P-1
LG&E Capital Corp	A3*/P2*
Powergen US Funding LLC	Baa1*/P-2*
Scottish Power plc	Baa1
Scottish Power UK plc	A2 (guar.)/A3, P-2 (non guar.)
SP Transmission	A2
SP Distribution	A2
Scottish Power Investments	A2
SP Manweb plc	A2
SP Generation	A3
ScottishPower Energy Retail	A3
SP Energy Trading	Baa1
Southern Water Services Ltd	A2
Scottish and Southern Energy plc	Aa3/P-1
Southern Electric Power Distribution plc	Aa3
Scottish Hydro-Electric Power Distribution Ltd	Aa3
Scottish Hydro-Electric Transmission Ltd	Aa3
SSE Energy Supply Ltd	A1
SSE Generation Ltd	A1
TXU Corp.	Baa3/P-2
TXU International Inc.	
TXU Europe Ltd	Baa1
Energy Group Overseas BV	Baa1
TXU Europe Group plc	Baa1
TXU Eastern Funding Company	Baa1/P-2
TXU Europe Capital I	Baa3

(1) Nov 2001 offer by London Electricity Group to TXU Europe to acquire distribution assets of Eastern Electricity
(2) April 2001 conditional offer by E.ON to acquire Powergen plc

II. Distribution and Supply Utilities

American Electric Power Company Inc.	Baa1/P-2
CSW International, Inc.	
CSW Investments	Baa2
Seeboard plc	Baa1/P-2
Seeboard Power Networks plc	Baa1
Seeboard Energy Ltd	Baa1

Appendix IV:

UK Electric Utility Groups—Moody's Ratings

III. Distribution and Transmission Utilities

FirstEnergy [(3)]	Baa2
Avon Energy Partners Holdings	Baa2**
Midlands Electricity plc ("GPU Power UK")	Baa1**
GPU Power Networks (UK) plc	Baa1**
National Grid Group plc	A2
The National Grid Company plc	A1/P-1
National Grid USA	P-1**
Massachusetts Electric Company	A2/P-1
Narragansett Electric Company	A2/P-1
New England Power Company	A2/P-1
(Niagara Mohawk Power Corp. (acquisition in process))	Baa3
MidAmerican Energy Co/Berkshire Hathaway	A3/P-1
CE Electric UK Funding Co	Baa1
Northern Electric plc	A3/P-2
Nothern Electric Distribution Ltd	A3
Northern Electric Finance plc	A3
Yorkshire Power Group Ltd	
Yorkshire Power Finance Ltd	Baa1
Yorkshire Capital Trust 1	Baa2
Yorkshire Electricity Group plc	
Yorkshire Electricity Distribution plc	A3
United Utilities PLC	A3/P-2
United Utilities Electricity PLC	A2/P-1
United Utilities Water PLC	A2/P-1
North West Water Finance PLC	A2/P-1
Mirant/PP&L	Baa2,P-2/Baa3
WPD Holdings UK	Baa2
Hyder Industrial Group Ltd	
Western Power Distribution (South Wale) plc	Baa1
WPD Holdings Ltd	
SIUK plc	Baa1
Southern Investments UK Capital Trust 1	Baa2
Western Power Distribution (South West) plc	Baa1

(3) Offer by Utilicorp United to FirstEnergy to purchase Avon Energy Partners (October 2001)

IV. Power Generators

The AES Corporation	Ba1
AES Drax Energy Ltd	B1
AES Drax Holdings Ltd	Ba1
British Energy plc	A3
International Power	Ba3
International Power (Cayman) Ltd	Ba3

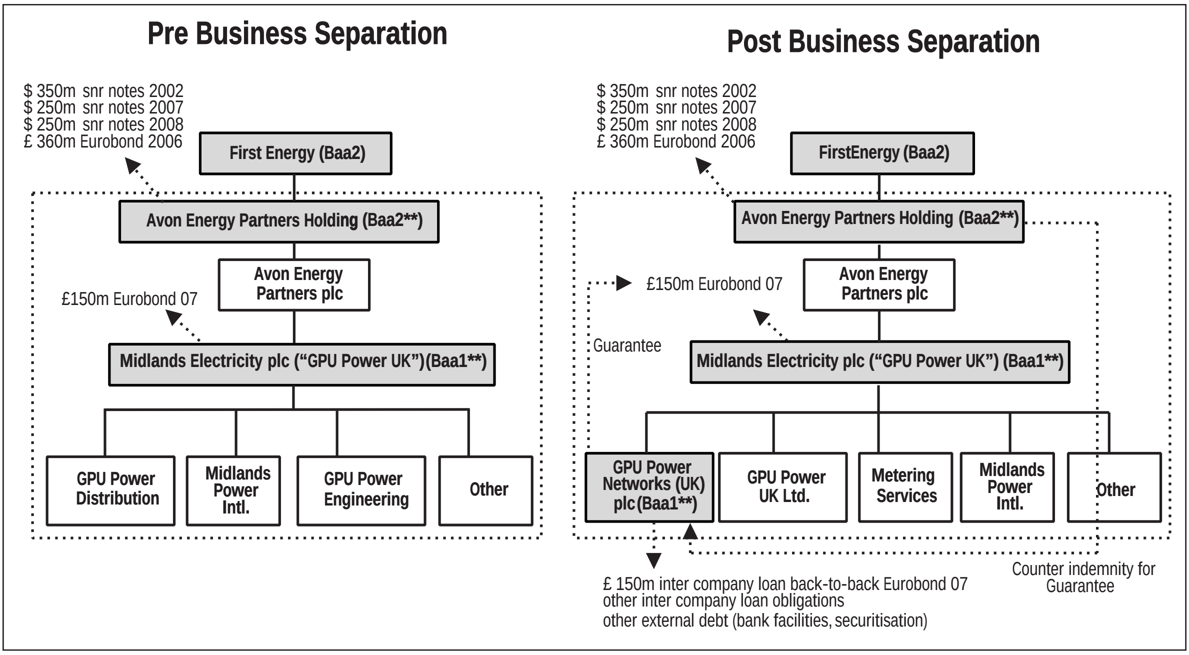
Appendix V

UK Electric Utilities

Group Structures and Selected Commentary

AVON Energy Partners/Midlands Electricity ("GPU Power UK")

GROUP STRUCTURE

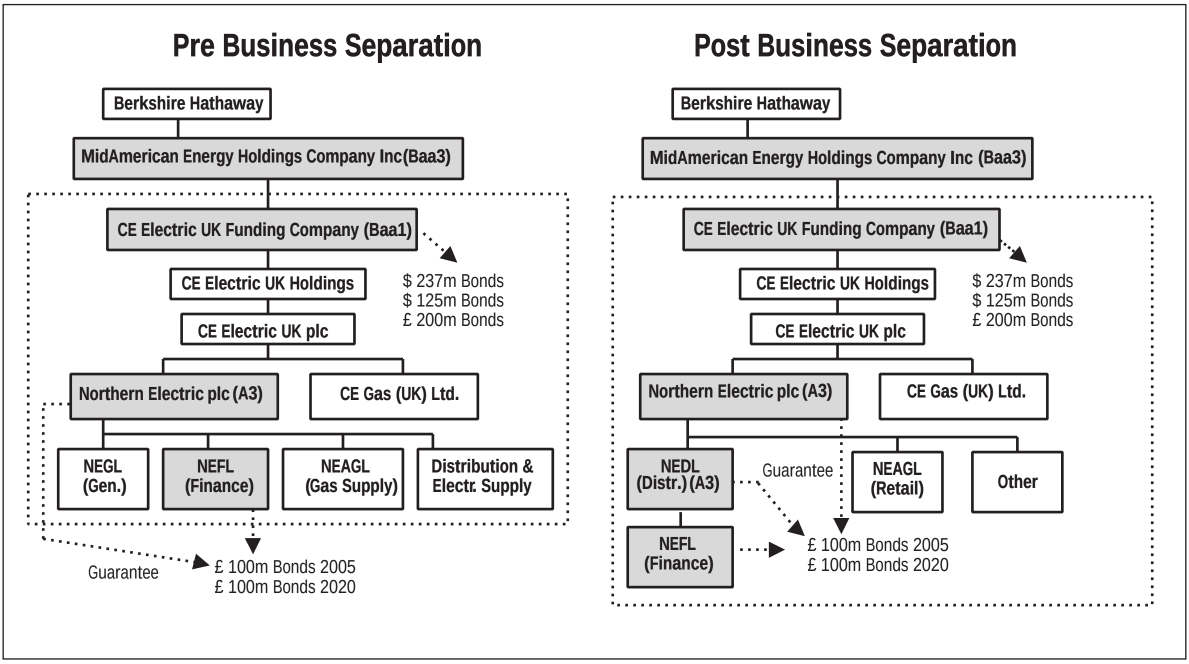


Commentary

- Midlands Electricity, which trades under the name of GPU Power UK, is a distribution-only business. The company sold its supply business to Innogy plc in 1999. In addition, the company has some electricity generation investments that are held in its Midlands Power International subsidiary.
- The new distribution license holder is GPU Power Networks plc, a subsidiary of Midlands Electricity. Network maintenance and operations are performed by GPU Power UK Ltd, which employs the vast majority of the group's personnel.
- Credit implications for bondholders of Midlands Electricity plc:
  - The £150m 2007 Eurobond remains a direct obligation of Midlands Electricity plc. In addition, bondholders benefit from an upstream guarantee from the regulated monopoly network subsidiary, GPU Power Networks. This upstream guarantee is only for the benefit of the existing 2007 bond. The guarantee is back-to-back with an intercompany loan obligation between GPU Power Networks and Midlands Electricity for the nominal amount of the bond.
  - OFGEM required an indemnity to be given to GPU Power Networks from Avon Energy Partners Holdings for the upstream guarantee.
  - With the exception of the 2007 Eurobond, all other debt of Midlands Electricity plc has been "pushed down" to GPU Power Networks.
  - Moody's expects that any new debt in the future will be raised at the GPU Power Networks level.
- Credit implications for bondholders of Avon Energy Partners Holding:
  - Bondholders at the Avon Energy Partners Holding level are now one step removed from the regulated network entity. This is mitigated by the fact that Midlands Electricity is not expected to raise any new debt of its own.

CE Electric UK/Northern Electric (pre Yorkshire Electricity asset swap)

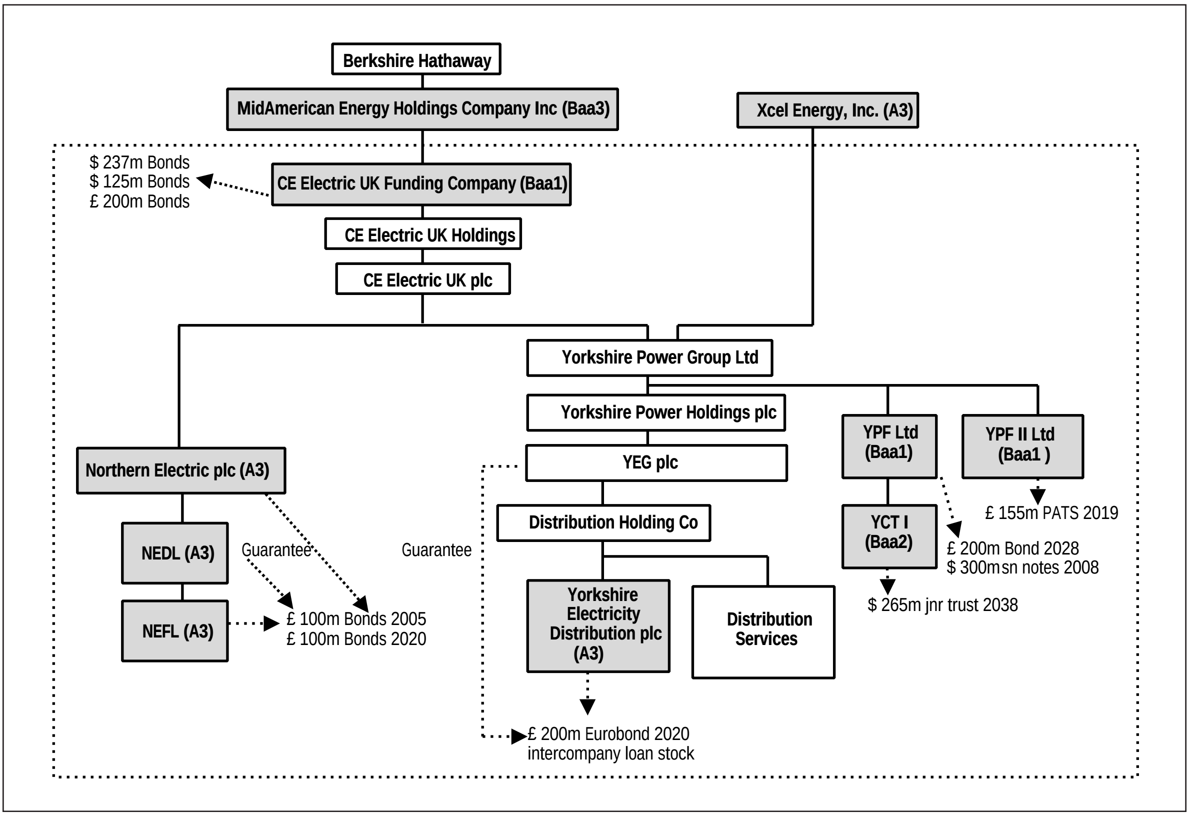
GROUP STRUCTURE



Commentary

- The new holder of the distribution license is Northern Electric Distribution Limited ("NEDL"). In addition, Northern Electric Finance plc ("NEFL"), the issuer of the 2005 and 2020 Sterling bonds, has become a direct subsidiary of the regulated distribution subsidiary.
- Credit implications for bondholders of Northern Electric Finance plc
  - Whilst the two bonds were previously guaranteed by Northern Electric plc, they are now jointly and severally guaranteed by Northern Electric plc and NEDL.
  - As a subsidiary of the new distribution license entity, Northern Electric Finance Ltd is limited to undertaking distribution related finance activities. The cross-default provision excludes any cross default to other, non-distribution borrowings within the group.

CE Electric UK/Northern Electric (post Yorkshire Electricity asset swap)

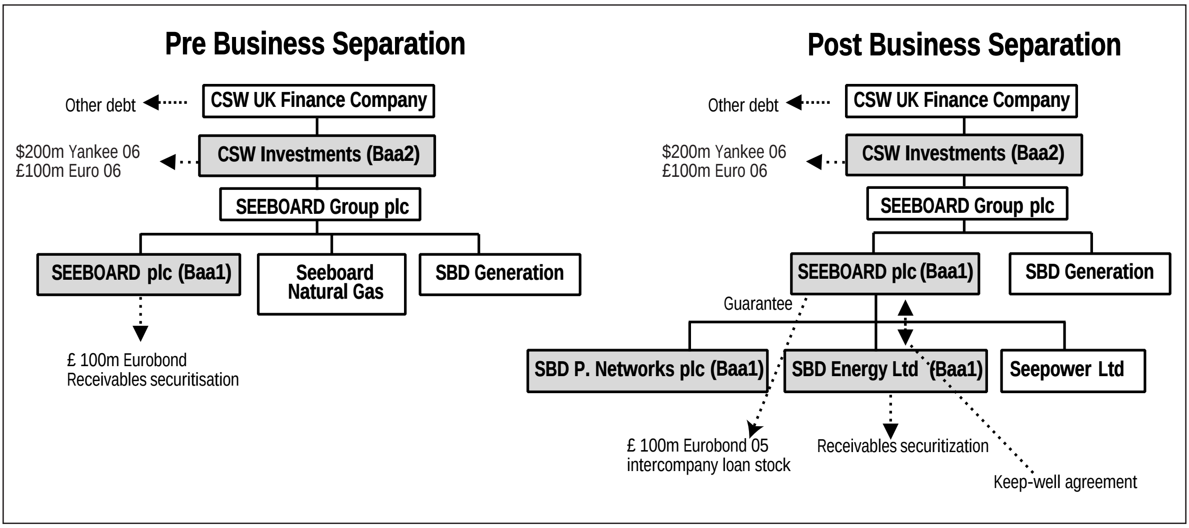


Commentary

- Following the asset swap transaction between CE Electric UK Funding and Innogy plc in August 2001 (transfer of Yorkshire's supply business to Innogy; sale by Innogy of the remaining Yorkshire Power Group to CE Electric UK; sale by CE Electric UK of Northern Electric's supply business to Innogy), the Yorkshire Power Group of companies is now a distribution-only business and a sister group of companies to Northern Electric underneath CE Electric UK plc.
- As part of the asset swap, the Yorkshire Electricity Group £150m 2005 and the Yorkshire Power Finance $350m 2003 bonds were repaid.
- Yorkshire Electricity Group ("YEG"), the previous holder of the Public Electricity Supply license, has become a holding company for the new regulated distribution license company, Yorkshire Electricity Distribution plc., and the network operations and maintenance subsidiary, Distribution Services.
- Credit implications for YEG bondholders:
  - The £200m 2020 Eurobond has been transferred to the ring-fenced Yorkshire Electricity Distribution plc, and also benefits from a downstream guarantee from YEG.
  - Bondholders are pari-passu with inter-company loan stock between Yorkshire Electricity Distribution and YEG.
- Credit implications for YPF bondholders:
  - YPF and YCT continue to rely on dividends from YEG (via Yorkshire Holdings) to meet debt obligations.

CSW Investments/SEEBORAD Group

GROUP STRUCTURE

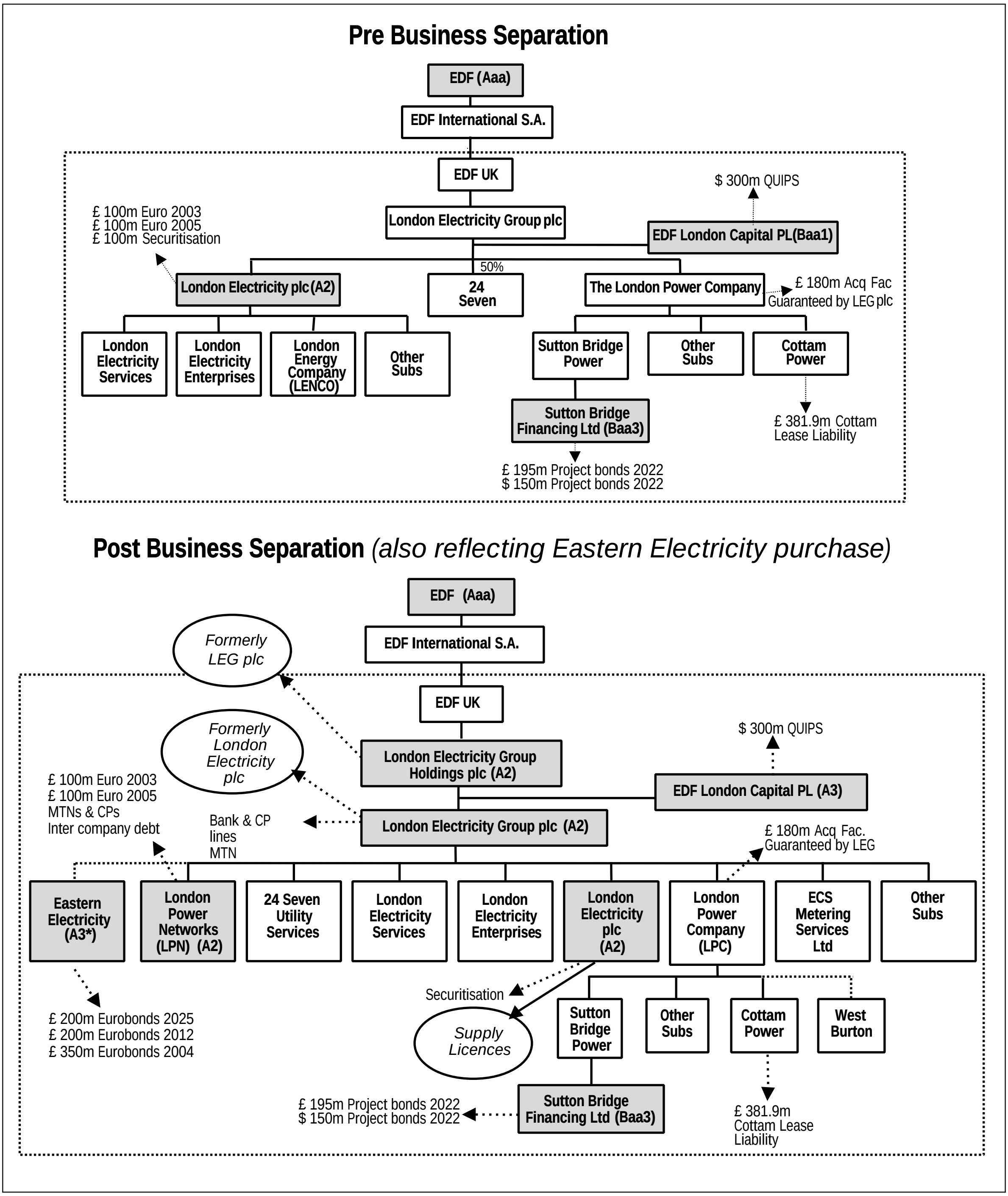


Commentary

- The distribution and supply activities have been transferred to SEEBOARD Power Networks plc and SEEBOARD Energy Ltd, respectively. SEEBOARD plc has become a holding company for all but the generation activities, which remain a subsidiary of SEEBOARD Group plc.
- Credit implications for SEEBOARD plc bondholders:
  - The £100m SEEBOARD plc Eurobond has been “pushed down” to SEEBOARD Power Networks plc. The business risk of this ring-fenced entity improves as bondholders are no longer exposed to the volatile and competitive electricity supply activities. In addition, bondholders benefit from a guarantee from SEEBOARD plc.
  - SEEBOARD Power Networks plc bondholders rank pari-passu with inter-company loan stock which SEEBOARD Power Networks plc has with its parent SEEBOARD plc. This intercompany loan stock was created as part consideration for the transfer of distribution assets.
- Credit implications for CSW Investments plc bondholders:
  - Bondholders at the CSW Investments level are now one step further removed from the regulated distribution cash flows. This is mitigated by the fact that the company has no plans to raise additional debt at the SEEBOARD plc level.
  - There are no underlying economic changes as a result of business separation. Debt protection measures on the group level remain unchanged
- SEEBOARD Energy Ltd’s rating is based on the credit of SEEBOARD plc, formally underpinned through a keep-well agreement.

EDF/London Electricity Group

GROUP STRUCTURE



Commentary

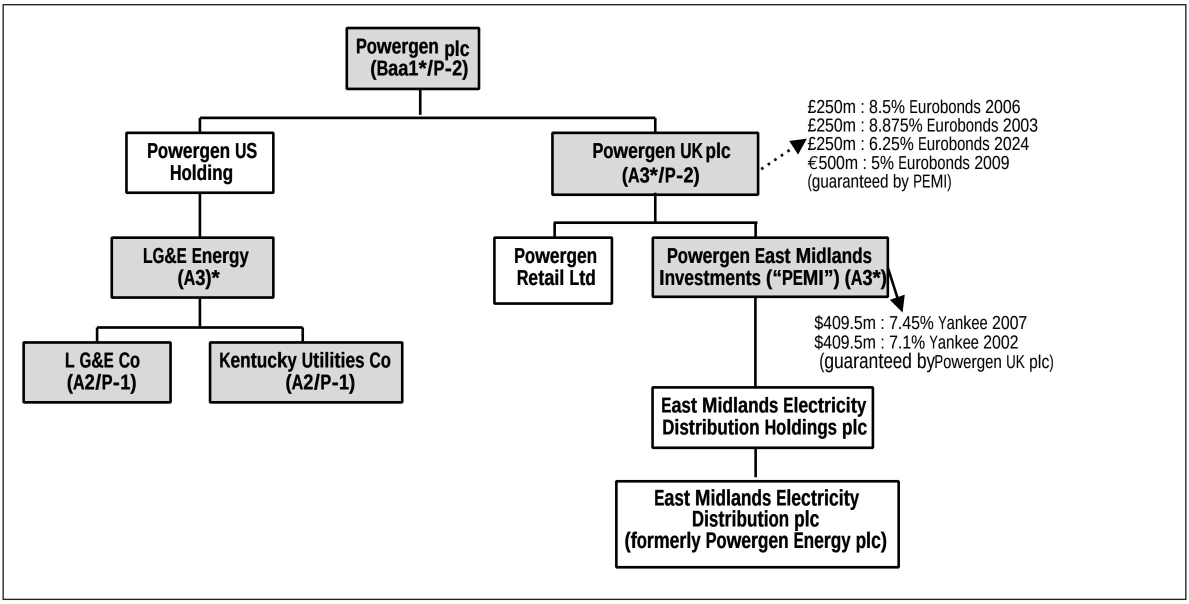
- London Electricity has taken the opportunity of making a wider group restructuring at the same time as the Transfer Scheme was implemented. This resulted in a "flattening" of the group structure below the previous London Electricity Group plc level.
- London Electricity plc, the previous holder of the Public Electricity Supply license, has transferred its distribution assets to the newly created London Power Networks plc ("LPN"). The group's supply activities, trading under the London Electricity, South West Electricity, and Virgin Energy brands, have been concentrated in what used to be London Energy Company plc ("Lenco"). As a result, London Electricity Group has become the immediate holding company for all operating activities of the group.
- There has been a series of name changes which at first may be confusing as previously familiar company names are now associated with entities that bear little resemblance to the previous entities:

Previous Name	New Name
London Electricity plc (LE)	London Electricity Group plc ($LEG_{(new)}$)
Previous PES license holder: distribution, trading, supply	*Holding company for all operating activities of the group. In addition, $LEG_{(new)}$ undertakes the group's trading and risk management functions*
London Electricity Group plc (LEG)	London Electricity Group Holdings plc (LEGH)
Intermediate holding company	*Intermediate holding company*
London Energy Company (Lenco)	London Electricity plc ($LE_{(new)}$)
Supply	*Supply (London Electricity, SWEB, and Virgin Energy brands)*

- Credit implications for London Electricity bondholders:
  - The two £100m 2003 and 2005 Eurobonds of LE have been transferred to the regulated network subsidiary London Power Networks. Bondholders benefit directly from cash flows of the regulated distribution entity without exposure to the competitive supply activities.
  - A CP program remains with London Electricity Group plc $_{(new)}$.
- Other changes:
  - A guarantee for creditors of a £180m acquisition facility of The London Power Company for the Sutton Bridge IPP is now provided by London Electricity Group plc instead of by London Electricity Group Holdings plc.
  - The transfer of the distribution assets from the (old) London Electricity plc to London Power Networks plc has created intercompany loan stock between these two entities.
  - Since London Electricity Group plc has both operating and holding company functions, it will require financing in its own right and to support group activities. The fact that this company now guarantees the LPC acquisition facility and that it is the immediate holding company of all other group activities has weakened the financial profile of London Electricity Group plc on a standalone basis.
  - The London Electricity group of companies continue to benefit from the support of its ultimate parent Electricité de France (EDF, rated Aaa).

Powergen plc

GROUP STRUCTURE

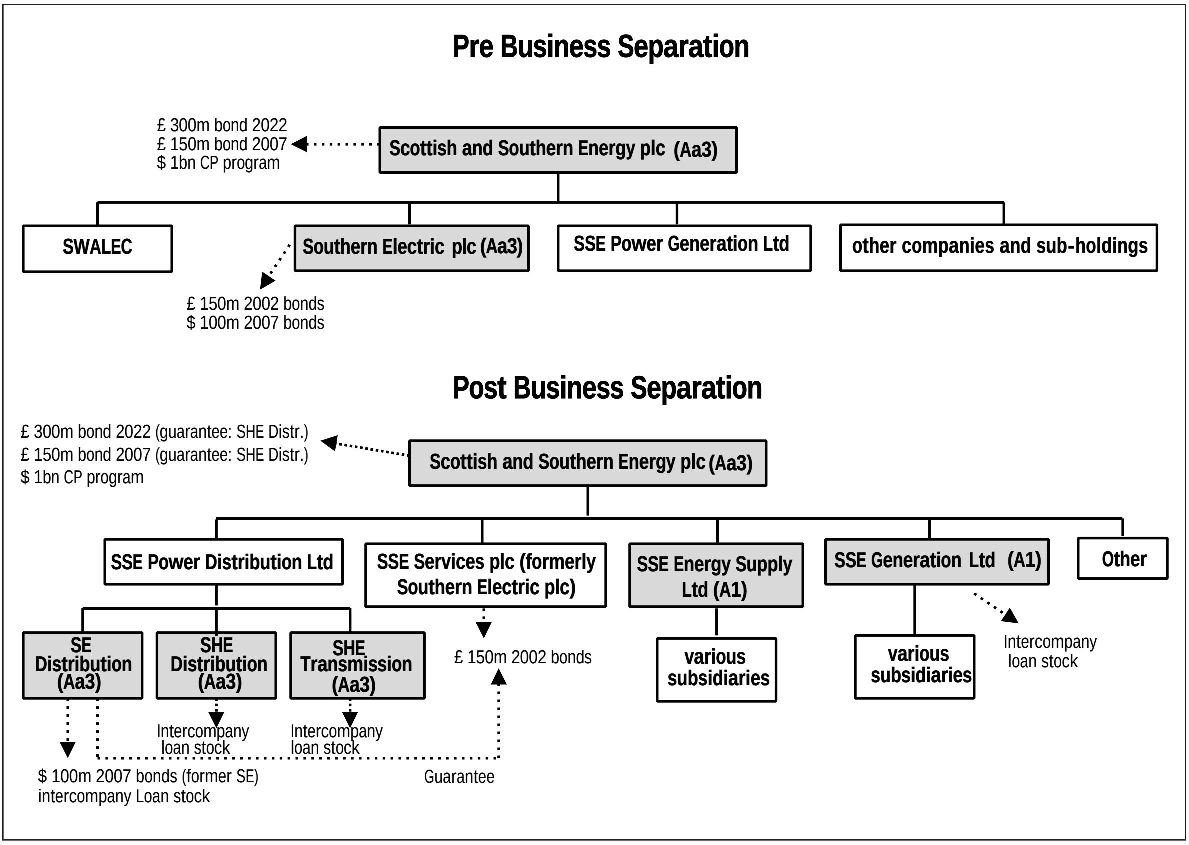


Commentary

- The group's electricity supply business was transferred from Powergen Energy plc to Powergen Retail Gas Ltd. Powergen Energy plc was subsequently renamed East Midlands Electricity Distribution plc, and Powergen Retail Gas Ltd was renamed Powergen Retail Ltd. The latter now comprises the group's entire retail activities, including gas and electricity.
- The £100m 2006 and £150m 2016 bonds of Powergen Energy plc were redeemed in December 2000 in anticipation of the business separation process, leaving East Midlands Electricity Distribution plc with no external debt.
- A new intermediate holding company called East Midlands Distribution Holdings plc has been created between Powergen East Midlands Investments and East Midlands Electricity Distribution plc.

Scottish and Southern Energy Group

GROUP STRUCTURE



Commentary

- The Utilities Act 2000 affected two group entities: Scottish and Southern Energy plc (SSE) and Southern Electric plc (SE). In addition, the company used the occasion to implement a much wider corporate restructuring at the same time as business separation.
- SSE transferred all of its operating activities to new entities in return for share capital and loan stock. The new regulated subsidiaries are Scottish Hydro-Electric Power Distribution Ltd ("SHE Distribution") and Scottish Hydro-Electric Transmission Ltd. SE also transferred its supply and distribution activities to new entities, with the regulated company being Southern Electric Power Distribution plc ("SE Distribution"). The share capital held by SE in its new subsidiaries has subsequently been transferred to SSE.
- SSE has become a pure investment holding company, and SE a facilities management company. SE has been renamed SSE Services plc.
- Credit implications for bondholders:

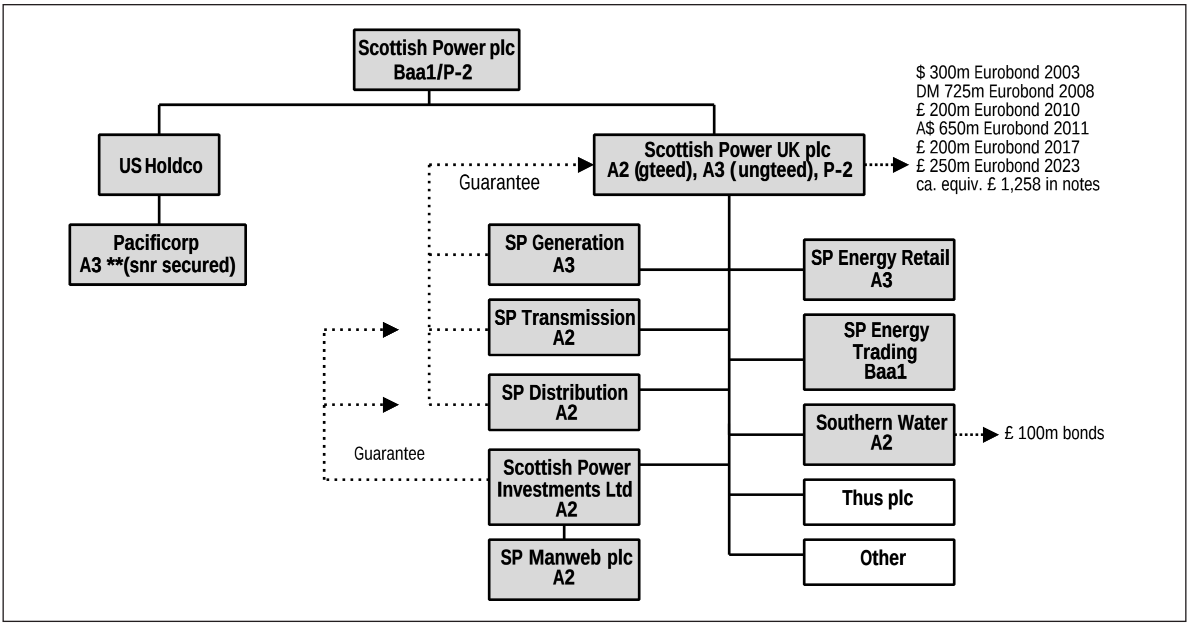
  - SSE's £ 300m 2022 and £150m 2007 bonds remain with SSE and benefit from up-stream guarantees from SHE Distribution.

  - The £150m 2002 bond issued by SE remains with SE with an upstream guarantee from SE Distribution. SE's US$ 100m 2007 bond has been transferred directly to SE Distribution.

  - The parent rating is underpinned by the cash flows from the regulated subsidiaries, the diversity of cash flows, and the company's strong and conservative management.

Scottish Power Group

GROUP STRUCTURE

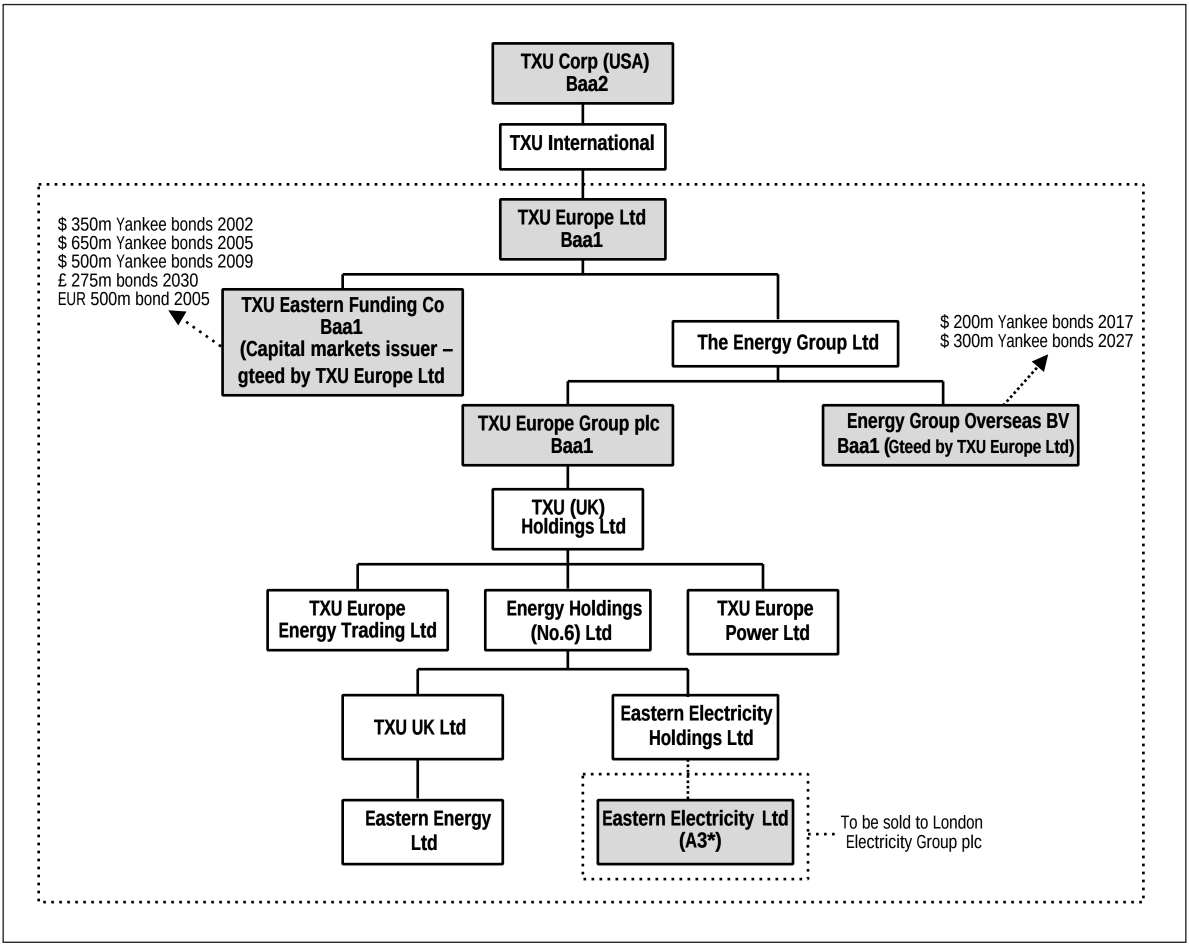


Commentary

- Scottish Power has significantly restructured its group. All operating activities now reside in separate, wholly-owned subsidiaries of Scottish Power UK ("SPUK").
- There are four regulated monopoly subsidiaries within the SPUK group: SP Transmission Ltd (Scottish electricity transmission), SP Distribution Ltd (Scottish electricity distribution network), SP Manweb plc (Manweb electricity distribution network), and Southern Water (the regulated water business).
- Unregulated subsidiaries that operate in competitive market segments include Scottish Power Generation, which owns all SPUK generation in the UK, ScottishPower Energy Retail, the domestic supply business, and Scottish Power Energy Trading, the group's trading entity that acts as principal counterparty to trading obligations.
- Credit implications for bondholders:
  - Most of the existing SPUK debt is kept at SPUK, and the new subsidiaries are generally debt-free (except for some EIB debt at SP Transmission and SP Distribution).
  - Existing SPUK debt (in place prior to 1st October 2001) will benefit from guarantees from SP Transmission, SP Distribution, and SP Generation. SP Transmission and SP Distribution are guaranteed by Scottish Power Investments, the holding company of Manweb. On the basis of this guarantee structure, the long-term ratings of the existing SPUK debt was maintained at A2.
  - Due to regulatory requirements, any long-term debt issued by SPUK after 1st October 2001 will not benefit from up-stream guarantees and will hence be legally subordinated to guaranteed SPUK debt. Any such future unguaranteed debt would be rated one notch below the guaranteed debt. At the same time, SPUK's long-term issuer rating has moved to A3 and the short-term rating to Prime-2 from Prime-1.
- Commercially, Scottish Power Generation, ScottishPower Energy Retail, and Scottish Power Energy Trading are interlinked, with Energy Trading "sitting" between Generation and Retail. Whilst these companies are an integral part of SPUK's activities and strategy, none benefit from a guarantee or formal support from any Scottish Power affiliate. The one-notch differential in the issuer ratings of Generation and Retail compared to those of their regulated affiliates reflects the greater business risks of these entities. The Baa1 rating of Energy Trading reflects the greater volatility of cashflows, which will be the entity directly exposed to external trading risks, plus the lack of any significant assets.

TXU Europe

GROUP STRUCTURE



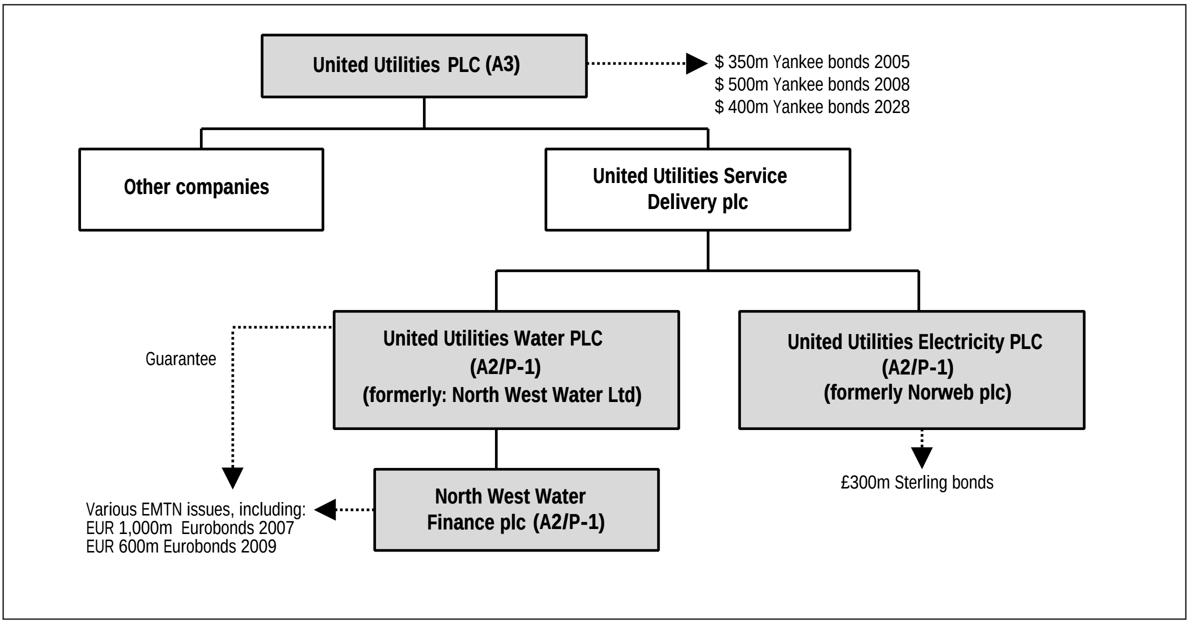
Commentary

- Prior to business separation, both the supply and distribution licenses/businesses were held within Eastern Electricity Ltd.
- Business separation resulted in the transfer of the supply business out of Eastern Electricity Ltd into TXU UK Ltd (formerly Eastern Natural Gas (Retail) Limited). The regulated distribution network business remained at Eastern Electricity. All electricity trading activities of the group are carried out by TXU Europe Energy Trading Limited.
- Nearly all of the group's recourse debt is guaranteed or raised by TXU Europe Ltd. There is no debt at the intermediate companies, which is the reason for there not being any notching differential between TXU Europe Group plc and TXU Europe Ltd.
- Credit implications for bondholders:

Bonds were unaffected as they stayed with Eastern Electricity as the new distribution license holder. The transfer of the supply business out of Eastern Electricity was not deemed a material change.

United Utilities

GROUP STRUCTURE

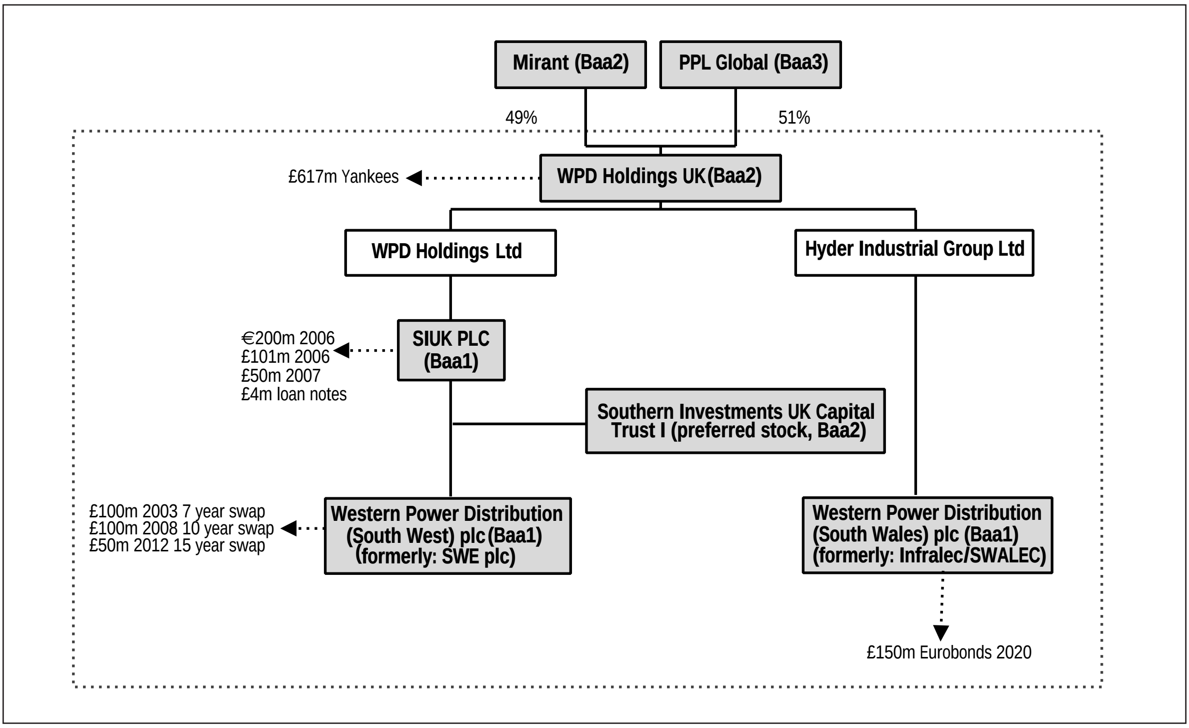


Commentary

- United Utilities sold the energy supply business of its United Utilities Electricity PLC (formerly Norweb plc) subsidiary to TXU Europe in August 2000. As a consequence, the transfer scheme did not lead to major changes within the group. Prior to license separation, TXU Europe met United Utilities Electricity PLC's residual supply-related obligations under its PES license by way of an agency agreement. Following license separation on 1 October 2001, these obligations were transferred via the transfer scheme to a new legal entity that was sold to TXU Europe. The distribution network business and license remained with United Utilities Electricity PLC.
- Separate from the Utilities Act's transfer scheme, North West Water Ltd was renamed United Utilities Water and converted into a Plc.
- Following this change in corporate status, United Utilities Water plc has been included as an issuer on the group's EMTN programme effective October 2001. North West Water Finance plc is now no longer an issuer on the programme going forward. The company is in the process of substituting United Utilities Water plc in place of North West Water Finance as the principal debtor in respect of outstanding notes issued in the name of North West Water Finance. United Utilities Water has been the guarantor of these notes to date. The substitution by itself does not have any effect on the current ratings.

WPD Holdings Group (Mirant/PP&L)

GROUP STRUCTURE



Commentary

- The requirement for business separation did not have any noteworthy impact on the Western Power Distribution (WPD) group, as the group is entirely focussed on regulated network businesses. WPD Holdings owns two network businesses: Western Power Distribution (South West) plc and Western Power Distribution (South Wales) plc
- WPD had sold the supply business of its Western Power Distribution (South West) plc subsidiary to London Electricity Group plc in 1999. The electricity distribution activities remain at Western Power Distribution (South West) plc, the former SWE plc (name change as from 1 August 2001).
- In addition to the South West of England network business, WPD Holdings acquired the South Wales Electricity distribution business through its purchase of Hyder plc. The distribution activities and license remain at Western Power Distribution (South Wales) plc (previously called Infralec and prior to that South Wales Electricity plc).

Appendix VI
Related Publications

Regional Reports

European Electric Utilities, Industry Outlook 2002 - October 2001

The Growing Impact of Regulation on the UK Electricity Sector - August 2000

Recycling the RECs - May 1998

Press Releases

Moody's Confirms London Electricity's ratings and puts Eastern Electricity on review for possible upgrade, following purchase - 15 November 2001

Moody's Places ratings of GPU Power UK/Avon Energy Group on review for possible downgrade following its acquisition by Utilicorp United - 19 October 2001

Moody's Assigns Ratings to new Scottish and Southern Energy plc Group Entities - 28 September 2001

Moody's Assigns Baa1 Ratings to New SEEBOARD Subsidiaries - 28 September 2001

Moody's Assigns Ratings to New Entities of London Electricity Group - 28 September 2001

Moody's Assigns New Ratings to Scottish Power Group Companies - 28 September 2001

Moody's Confirms ratings of Innogy plc at Baa1, Northern Electric plc at A3 and CE Electric UK at Baa1, and places ratings of all entities of Yorkshire Power Group plc under review for upgrade following announcement of proposed asset swap - 6 August 2001

Rating Methodologies

Rating Methodology - Australian and New Zealand Utilities - February 2001

Rating Methodology - Electric Utility Holding Companies - April 2000

Creeping Leverage: Growth in Electric Holding Company Debt - April 2000

Rating Methodology - European Electric Utilities - June 1999

Special Comments

Electric Industry Restructuring Case Study: Assigning Indicative Ratings in the Reliant Energy In's Demerger - March 2001

Ratings Gap between Electric Utilities And Their Holding Companies Widens - March 1998

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